

The University of Chicago

ECONOMIC ASPECTS OF
UNEMPLOYMENT INSURANCE IN
GREAT BRITAIN

A PART OF A DISSERTATION SUBMITTED TO
THE FACULTY OF THE DIVISION OF THE
SOCIAL SCIENCES IN CANDIDACY FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF ECONOMICS

1932

By
NEWMAN ARNOLD TOLLES

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More than twenty years ago, Great Britain put into operation the first national system of compulsory unemployment insurance. Ever since 1921, the system has had to function in the face of a prolonged business depression. Frequent modifications of the law have been required, mainly as a result of this unexpected stress. Parliament has passed twenty-five separate enactments since 1911, and further changes are still imminent. Yet there are no signs that the system will be abandoned as a result of this extensive and searching test. No witnesses appeared before the recent Royal Commission to propose abandonment, and the Commission's report makes it clear that the state will continue to guarantee a minimum of protection against the risk of involuntary idleness.¹ The advocates of compulsory unemployment insurance in the United States have thus gained a source of comfort as well as a guide to many technical details of a successful plan.

The doubts concerning such insurance center about its economic effect. Many persons who admit its efficiency as a relief measure still believe that it must act to increase the volume of unemployment. Such a criticism has arisen out of the British experience, as might have been expected. Four separate attacks have been made. Some students have believed that the British depression can be traced to the policy of maintaining wages at too high a level, and it has been alleged that the insurance

¹ Royal Commission on Unemployment Insurance, Judge Holman Gregory, chairman, Minutes of Evidence, December 19, 1931, ff.; idem, Final Report, London, 1932.

system was responsible for this. Others have contended that British industry was overwhelmed by the burden of taxes, and the cost of insurance benefits has thus been attacked. A different class of critics have blamed the unemployment upon the immobility of labor, and it has thus been thought that the insurance system interfered with Britain's efforts to improve mobility. Finally, there is the popular argument that a man who is insured against unemployment will be unwilling to work. It is the purpose of this paper to test each of these contentions, and so to weigh the crucial question upon which the case for unemployment insurance must ultimately stand or fall.

I. Exceptional Factors in Britain's Post-War Unemployment

Before examining the specific criticisms of unemployment insurance, it will be well to set forth the general economic situation out of which these criticisms arose. At first sight, the British experience seems to indicate that the insurance system did have an unfortunate economic effect. It was not until 1921 that the great mass of British workers were included in the system. The experimental scheme of 1911 reached a little more than two million workers, while war-time extensions and the growth of population had increased the number to somewhat over four millions by 1920. In the last month of 1920, unemployment insurance was extended to cover nearly all of the industrial, wage-earning population, a number that has since stood between eleven and twelve millions. Now ever since 1921, the rate of unemployment in Great Britain has been remarkably high. Judging from trade union returns, her pre-war unemployment rate averaged about six per cent, taking good and bad years together. Since 1921, the rate has never been lower than nine per cent. During 1921 and

since 1930, it has been around twenty per cent. Under such conditions it is natural that the insurance system should be suspected of adding to the unemployment burden.

For our present purpose, there is no need to pay attention to the years of most severe unemployment. Whatever the causes of world-wide depression may have been, it is clear that there was nothing exceptional about British unemployment during 1921-1922 and 1930-1932. At both times, every important commercial nation found itself with large numbers of idle workers.¹ Indeed, the United States appears to have suffered more severely than Britain at both these times, in spite of the fact that the American development of unemployment insurance was negligible. As to the years 1923 and 1924, there is small room for blaming Britain's unemployment upon her insurance system. In the two years together, the unemployment of insured workers in Britain was reduced by 180,000, or, in percentages, from thirteen per cent to ten per cent. It is true that Britain's recovery from the 1921 depression was slower than in the United States. But if the 1921-1922 depression had been cushioned in Britain, as the lower rate of unemployment leads us to suppose, it is reasonable to suppose that the subsequent re-adjustments would be slower in Britain than in the United States. There were many peculiar impediments to the recovery of British industry which need not be detailed here. And in any case, definite progress was being made during 1923 and 1924 toward the restoring of Britain's pre-war employment proportions.

The crucial years for our inquiry are those between 1925 and 1929, for it is that period which presents us with the

¹ Except that paper money inflation delayed the 1921 depression in some countries of continental Europe, notably in Germany.

strongest apparent case against Britain's insurance system. An average of about eleven per cent of the insured population remained unemployed. This was nearly twice the pre-war average and certainly it was a much higher figure than that for the United States. Moreover, there was little deviation from this average. Even in 1927, when British industry was catching up on orders deferred during the coal strike, the unemployment rate fell to only 9.7 per cent. Accordingly, our attention will be centered upon these years. If insurance were a constant factor, operating to keep up the rate of unemployment, it might well have made things worse in the more depressed years. But the relatively good years will furnish us with the most conclusive evidence, one way or the other.

When we limit our attention to the period, 1925 through 1929, we find that Britain's condition can be explained quite adequately without supposing that her unemployment insurance system was working adversely. Great Britain suffered from one great error of domestic policy, which was peculiar to her, the deflation of 1925. And she suffered, at the same time, from a number of foreign influences which acted to depress her industry and to make the error of 1925 more serious. Unless we understand these factors, we shall be led to distorted conclusions about the insurance system.

The price-deflation of 1925 was deliberately undertaken in order to restore the pre-war parity of 4.866 between the pound and the gold dollar. By the middle of 1924, the pound sterling had reached a fairly steady level of around 4.40, or about ten percent below the desired parity. Britain was still off the free gold standard, as she had been since 1914. In 1925, Britain not only returned to the gold standard, but restored the pre-war parity. The return to gold was felt to be important in order to

avoid the possibility of a great inflation, such as was being witnessed in other countries which had been forced off the gold standard as a result of the war. A currency tied to gold seemed comparatively safe and predictable. Moreover, it was certain that the United States would continue on the gold standard, and the Genoa Conference of 1922 made it seem probable that the rest of Europe also would eventually return to gold. So long as every country succeeds in keeping its currency convertible into the same metal at a fixed ratio, the rates of foreign exchange between them can fluctuate only within narrow limits.¹ This is a real advantage in all international transactions, since the trader can count upon a definite domestic value for all payments in the foreign currency. Now British commerce and banking depend upon foreign transactions to a unique degree. Thus, there was an obvious advantage in adopting a standard in common with most of the other nations.

The return to gold did not necessitate a price deflation, however, unless and until other countries on the gold standard experienced a drastic decline in their price levels. The deflation of 1925 was made necessary by the decision to raise the external value of sterling. All the other European belligerents ultimately de-valued their currencies, making them convertible into a lesser quantity of gold than before the war. Britain chose not to do this. The only valid justification for restoring the pre-war ratio between gold and sterling lay in the belief that such a step would promote future confidence in the value of obligations expressed in sterling. As it turned out, Britain suffered five years of industrial depression, even before 1930, while chasing the chimera of "international confidence in sterling." In 1931,

¹ I.e. between the "gold points," or twice the cost of shipping gold between any two of the countries involved.

she had to leave the gold standard, after all. The prize slipped out of her grasp in spite of the sacrifices which had been made to obtain it.

Such was the publicly stated justification for the restoration of pre-war parity. But we must not neglect the self-interest of the rentier classes within Britain, represented by the bankers in whose hands the whole matter lay. They naturally stood to gain from a fall in prices. But whether prices fell or not, they stood to gain on all foreign investments which were expressed in sterling, as most of them were. A rise in the value of sterling would increase by so much the purchasing power of foreign debts owed to British investors. The rise of ten percent in the value of sterling gave these investors a bonus of about twenty million pounds in respect of interest alone.¹

In deciding to raise the external value of sterling, it is possible that the British authorities were gambling upon a rise of prices abroad. If so, they were disappointed. Barring such a rise, the increase in the external value of the pound made it necessary to raise the internal value also. Only by forcing a price deflation at home, could free gold movements be allowed without a consistent loss of gold by the Bank of England. Otherwise the relatively high prices in England would have encouraged imports and discouraged exports. Moreover, the relative cheapness of foreign currencies, when purchased by Englishmen, would have encouraged foreign lending, and the dearth of the pound would have discouraged the deposit of foreign funds for use within Britain. The visible and invisible items of the balance of

¹ Net interest on British foreign investments was estimated at £220 million for 1924. (cf. C.G. Clark, "Statistical Studies of the Present Economic Position of Great Britain," Economic Journal, September, 1931, p. 368).

payments would have worked together to make necessary a constant flow of gold out of England to balance the excess of debit items.

If the British government had had the power to reduce every sterling price simultaneously by the required ten percent,¹ the deflation might have been painless. But the only available weapon at the government's command was that of restricting the volume of commercial borrowing by raising the Bank rate. During July 1924 appropriate measures were taken to make the existing four per cent rate "effective," and in March 1925 the rate was raised to five per cent. The initial effect was all that could have been desired. Restricted borrowing meant restricted purchasing, or as Mr. Keynes would put it, "an excess of savings over investment." Wholesale prices, which are the prices which immediately affect the international balance of payments, had fallen by the required amount by the end of 1925. But this step was only the beginning of the battle, not its conclusion. Unless unit costs of production were also reduced, the new level of selling prices could not provide a sufficient return to management to make worth while the business expansion which was required to absorb the unemployed. Credit restriction has no power to readjust the costs of production. It can only operate to cause business losses (i.e. negative pure profits taking all enterprises together). What happens after that depends upon how business reacts to these losses.

¹ We are assuming here that the 1924 exchange rate of about 4.40 expressed the approximate purchasing power parity of the pound and the dollar. This point has been in dispute. Professor T.E. Gregory estimated that sterling was under-valued in 1924; Mr. R.G. Hawtrey estimated that it was over-valued; Professor Keynes estimated that the exchange rate just about expressed the purchasing power parities at that time. (cf. Henry Clay, The Post-War Unemployment Problem, London 1929, pp. 71-72.) Aside from the validity of the various measures used, there is some evidence that Professor Keynes was right. The comparatively stable exchange rates during the middle of 1924, and Britain's subsequent difficulties in maintaining the higher parity lead us to accept Keynes' position.

In the face of these losses, it was possible for British enterprise (a) to do nothing, (b) to reduce the costs of production, or (c) to restrict production. Mr. Keynes believes that many concerns simply took their losses and did nothing about it for some time.¹ This merely postponed the necessary re-adjustment. If it had been possible to reduce unit costs quickly, normal profits might have been restored at the new value of sterling, and the absorption of the unemployed might have continued. But cost-reduction was not as easy as credit restriction, for reasons which we shall examine later. Hence the dominant and continuing effect of the return to pre-war parity was that of artificially restricted enterprise. The external equilibrium, which had been forced, was held, between 1925 and 1931, at the expense of internal disequilibrium. Thus, the unusual rate of unemployment during these years may thus be traced back to the monetary policy adopted. This policy was the novel influence at work in Great Britain. We shall inquire presently as to the possible influence of insurance upon the difficulty of reducing costs. But it should be clear already that the insurance influence was no more than a contributory factor to the trouble which the deflationary policy had created.

There had been a plausible argument for deflation in 1925, because it seemed that the readjustment need not be very drastic. Presumably no one would have thought that "international confidence in sterling" was worth many years of business depression. But with sterling only ten percent below its pre-war gold value, it could be argued that the deflation need not be great, nor the restriction of enterprise long-continued. This was a mistake.

¹ Treatise on Money, (London, 1930, Vol.II), p.183.

Britain's balance of foreign payments and receipts was precarious even in 1924, and it grew steadily more precarious after the gold standard was restored.

The very deflation which the new external equilibrium required was partly responsible for the subsequent difficulties. It is true that the fall in wholesale prices helped to maintain the external balance by stimulating exports and discouraging imports. But the failure to cut production costs sufficiently had the opposite effect. At the new prices, foreigners might profitably buy, but British enterprise could not profitably produce an increased quantity of exports. Instead of increasing, along with world trade, the physical volume of British exports remained practically at the 1924 level in the following five years. In money value, there was a ten per cent decrease in these exports. Meanwhile, the value of imports retained in Britain declined by only two per cent. On the visible trade account, Britain had an increasing amount to pay. Although this deficit was partly met by the increased money value of interest received from abroad, this latter item was too small in absolute size to keep the account as favorable as in 1924. The money value of Britain's net foreign balance of income from abroad averaged twenty per cent less than in 1924 during the following five years.

Now Britain normally lends a net amount abroad each year. The decrease in net income from abroad, just mentioned, might have been balanced by a decrease in such lending. This outcome was made impossible by the deflation itself. Investment in British enterprise was made unattractive because of the losses which credit restriction brought about, and foreign investment thus became relatively more attractive than before. Instead of decreasing, the money value of Britain's foreign loans remained almost

stationary. Considering the fall in prices, it is clear that the purchasing power of these foreign loans actually increased. A serious discrepancy therefore developed between the (declining) net foreign income and the (stationary) net amount of new lending to foreigners. This discrepancy tended to upset the balance of payments all over again. In order to forestall a continuous loss of gold, the Bank of England had to continue its credit restriction. Relatively high interest rates in London did attract foreign deposits for a time, but these rates also perpetuated the business depression and the unemployment at home. Once started, the deflation could not be stopped with the contemplated ten per cent fall in the prices. The external repercussion of the dis-equilibrium at home made necessary still further measures of deflation. These measures were effective. British wholesale prices at the end of 1929 were twenty per cent lower than at the end of 1924.

Those who chose the original deflation obviously underestimated the difficulty of bringing down production costs. In addition, they probably over-estimated Britain's income from abroad. Even before 1925, her position had been weakened, both as regards the income from foreign investments and the income from the sale of exports. Her unfavorable situation intensified the difficulty of holding gold at the new parity, and so prolonged the required period of credit restriction and unemployment.

Great Britain had met the war needs for foreign purchases by herself and her allies: (a) by selling the accumulated foreign investments of her citizens, (b) by borrowing from the United States, and (c) by lending net amounts to her allies which she collected in turn from her citizens. The principal sums involved in these transactions were roughly: £1,000 million, £1,000 million, and £750 million respectively. The loans to allies were

a dead loss in the period which concerns us. Even if we add in the receipts of German indemnity, Britain had more interest to pay to the United States between 1925 and 1929 than she received. Broadly speaking Britain sacrificed the interest on the £2,750 million of principal. At five per cent, this comes to about £138 million per year. Comparing this with the £231 million net interest from abroad which Britain did receive, we may estimate that these war transactions reduced Britain's foreign-investment income to nearly 40 per cent below what would otherwise have been earned. Without this income, it was all the more difficult to maintain external equilibrium at the high rate of sterling parity.

The continued deflation might have been avoided if Britain had been able to increase her income from abroad by increasing her exports of goods. But Britain's exporting industries had to work under grave handicaps, in additions to those imposed by increasing the value of sterling. The spread of machine industry had, even before the war, created severe competition in the markets which Britain was organized to supply. This industrialization proceeded even more rapidly during the war period, since Britain was unable to reach her foreign markets. Meanwhile Britain's great staple industries were prosperous without the need of increasing their efficiency, because of the pressure of war orders. If international trade had been allowed to proceed after the war with no more restriction than before, there would have been a drastic weeding out of high-cost plants the world over. But investors in the new foreign plants would not face such a risk of personal loss. They appealed to their governments to erect new and higher tariff barriers. This appeal was the more successful because the war had impressed many nations with the military advantage of self-sufficiency and because the post-war depreciation

of currencies furnished a pretext for protection against "exchange dumping." The anti-dumping tariffs were rarely removed when the occasion for them had passed. As a result, there grew up the world-wide mania for tariffs which continues to this day. Not only were tariffs raised and extended in scope, but frontiers were multiplied by the crop of independent states, newly created by the peace treaties. And the tariff barriers were supplemented by an array of other obstacles to free international trade: excessive consular fees, bounties to home manufacture, outright prohibition of imports, import quotas, and legal and social discriminations against foreigners. Moreover, the frequent changes in such trade barriers made exporting an unusually risky business.¹

The Balfour Committee found that, as a general rule, tariffs had been raised to the highest levels in the very countries which had been Britain's most important markets.² But Great Britain was the country which had most to lose from this tariff game, whether this was true or not. British industries, more than those of any other country, were organized so as to depend on sales abroad for profitable operation. Britain, more than any other country, depended upon imported foodstuffs and raw materials, and hence could least afford to contract her imports to meet a shrinkage of exports. Even under the wisest of domestic policies, the post-war interference with trade would have caused industrial disorganization and unusually heavy unemployment in Britain. In the

¹ Cf. League of Nations, International Economic Conference, 1927, Final Report; idem, Final Report of the Trade Barriers Committee of the International Chamber of Commerce, Geneva, 1927; Alfred Loveday, The Economic Consequences of the League, London, 1929; Sumner H. Slichter, "Do Tariffs Cause Depression," Current History, January, 1932.

² Great Britain, Committee on Industry and Trade, Survey of Overseas Markets, London, 1927, pp. 542-45.

face of this situation, the value of sterling was raised, depressing the export trades until such time as costs could be reduced, and at the same time calling for an unusual expansion of income from abroad if the new external equilibrium were to be maintained.

One further circumstance made the deflation an especially heavy weight upon the British export industries. This was the fact that Britain's European competitors had pursued an opposite policy. Price levels continued to rise in the countries of continental Europe while the level in Britain was forced to fall. However bad inflation may be for the general economy of a country, it must be admitted that it acts to subsidize the exports of the country inflating the most and to depress the imports of such a country. This is true because the external value of the inflated currency falls faster and farther than the internal value. Industrial costs therefore never rise sufficiently to cancel the exporting advantage of the low exchange rate. Britain's exports had to compete against the artificially subsidized exports of the inflating countries and to sell for quantities of foreign currency which produced a very small sum in sterling exchange.

It may be observed that most of this European inflation had come to an end by the period which concerns us, 1925-1929. Nevertheless, the damage to Britain's exports must have continued. Britain's competitors did not proceed to deflate prices as much as they had been inflated, but rather stabilized at the new low value of their respective currencies. This meant that a considerable proportion of the value of past debts, both governmental and private, was wiped out. By contrast, Britain had increased the burden upon industry of past debt charges, by her deflationist policy. Moreover, in France at least, the currency was stabilized at an external value which was unnecessarily low compared with its

internal value.¹ This perpetuated the profit advantage of French enterprise (at the expense of the French rentier class) and perpetuated the disadvantage of exporters to France. Finally, we must remember that it could not have been easy for British exporters to regain foreign markets which had been lost during the period of foreign inflation.

This sketchy analysis of Britain's economic position may seem to have little to do with the economics of unemployment insurance. But a study of unemployment is certain to be unfruitful if it is approached without regard to the economic situation of the time. The factors we have outlined do largely explain why British industry failed to absorb the unemployed during the relatively prosperous years, 1925 to 1929. The great bulk of this unemployment was in Britain's export industries. In 1924 these industries had been making some headway in spite of the spread of industrialism abroad, the new barriers to trade, and the concealed subsidy to foreign enterprise by inflation. But the policy of enhancing the external value of sterling proved too great a weight for these industries to bear, when this was added to all the others. A fall of internal prices had to be induced by credit restriction, and credit restriction did not suffice to bring down costs enough to restore the incentive to active investment at the new level of selling prices. Here we have a concrete explanation for the internal disequilibrium which perpetuated unemployment. This dislocation at home was bound to grow worse if it continued. The British depression encouraged an outward flow of British funds which could not be balanced by Britain's income from abroad. The war had sapped Britain's interest from investments, and the

¹ Cf. J.H. Williams, "The Gold Problem," Proceedings of the Academy Political Science, June 1931, p. 115.

depression in the export trades sapped her income from sales of goods. In these circumstances, a net loss of gold could be avoided only by the continuance of high interest rates, that is by the continued restriction of enterprise and employment.

If the foregoing analysis is broadly correct, then the primary explanation of Britain's peculiar, post-war unemployment is fairly independent of factors involving unemployment insurance. The coincidence of heavy unemployment with the complete establishment of the insurance system gives us no more than a prima facie case against insurance, at the most. Our inquiry, so far, indicates that advocates of unemployment insurance need not be embarrassed by the mere record of British unemployment. Given the unemployment, Britain must be considered fortunate in having been so well prepared with a system of relief.

It may still be true that unemployment insurance contributed to Britain's industrial difficulties: by encouraging resistance to wage-reduction, by adding to tax burdens, by interfering with mobility, or by making the insured unwilling to work. The evidence on each of these specific charges remains to be analyzed.

II. The Wage Problem

Following the world-wide deflation of 1921, Great Britain attained a sufficient measure of equilibrium between costs, sales prices and foreign exchange rates to make possible a hopeful revival of enterprise and a decrease in unemployment. Thereupon, in 1925, the external value of sterling was deliberately increased, and as a result it was necessary to restrict credit in Britain so as to bring down the level of internal prices. This pressure on the British price level immediately followed a comparatively stable level of prices (1923-1924) and it had to be continued right down to the next world depression of 1930, if the chosen

gold-parity of sterling were to be maintained. Once the selling prices of British products had been made to fall, it was, of course, necessary to reduce the money costs of production (per unit). Only thus could the profit incentive be restored to induce British enterprise to expand its production and continue the work of absorbing the unemployed. One way of reducing costs is to cut wage rates. But the average of British wage rates did not fall appreciably. Professor Bowley's index of wages in 1929 stood only 1 per cent below its 1924 level.¹ An impressive array of authorities have consequently contended that the high level of British wage rates was the cause of her abnormal rate of unemployment.²

The responsibility of unemployment insurance, according to this argument, was an indirect one. According to Professor Clay, who is intimately acquainted with wage negotiations in England, the knowledge that workers would receive a minimum of protection during enforced idleness had an influence upon the attitude of trade union officials. They became more willing to take the risk that the wage rate insisted upon might force a contraction, or at least hinder an expansion of employment. "This post-war disregard of unemployment," said Professor Clay, "is the

¹ Cf. London and Cambridge Economic Service, Bulletins, passim.

² This was undoubtedly the position of the following authors: M. Bo Gabriel DeMontgomery, (British and Continental Labour Policy, London, 1922, pp. 440-43), Professor Jacques Rueff, ("Les Variations du Chomage en Angleterre," Revue Politique et Parlementaire, Paris, December 10, 1925, pp. 425-36), Sir Josiah Stamp, ("Unemployment and Real Wages," Financial Times, London, January 6, 1926, pp. 50-51), Professor A.C. Pigou, ("Wage Policy and Unemployment," Economic Journal, September, 1927, pp. 355-67), M. André Siegfried, (England's Crisis, London, 1931, pp. 69-87), and Sir William Beveridge, (Unemployment, A Problem of Industry, new ed., London, 1930, pp. 359-72).

Sir William Beveridge has claimed that Professor Keynes and Professor Henry Clay held essentially the same view. (cf. Beveridge, op.cit., p. 361). But Professor Keynes has surely given primary emphasis to the responsibility of monetary policy. And Professor Clay has both indicated the practical difficulties in the

principal and direct explanation of the loss of plasticity in wage rates."¹

But Professor Clay himself was at pains to point out that unemployment relief was not the only factor, nor perhaps the principal factor responsible for "uneconomic" wage rates. He stressed the fact that, while nearly all wage scales had come under collective or governmental control, there was no co-ordinating body with the business of considering wages as a whole.² Now we shall see presently that British wages failed to fall because it was not in the interest of any of the sectional bargaining groups that they should fall. If that was so, it is somewhat beside the point to blame unemployment insurance for merely aiding groups of laborers to enforce what was in their economic interest. The whole mechanism of wage negotiation in Britain was ill-adapted to the task of arranging a smooth downward adjustment. This suggests that the necessity for downward adjustment ought to have been avoided, rather than that workers should have been stripped of the power to protect themselves. It cannot be doubted that an improved system of unemployment relief must increase the worker's "bargaining power" somewhat. (No one has been able to state how much.) But it is a strange reversal of the economic preachments of the past that this should suddenly be deplored. Let us grant that, under the peculiar circumstances, the insurance system had some effect in strengthening the wage-earners' resistance to wage reduction. Does it follow that a reduction of wage rates

way of wage reduction and put primary emphasis on the need for increasing industrial efficiency. (cf. The Post War Unemployment Problem, London, 1929, p. 156 and ch. VI).

¹ "The Public Regulation of Wages in Great Britain," Economic Journal, September, 1929, p. 337.

² Economic Journal, op.cit., p. 342.

was the one practical and desirable remedy for Britain's plight?

The crucial question in this whole argument as to the effect of insurance upon British wages is the question whether wage-cutting was the wisest remedy for British unemployment between 1925 and 1929. The assertion that high wages caused the unemployment means, if it means anything, that wage-cutting was a practical and wise public policy, under the circumstances. But the advocates of wage-reduction, eminent as they were, never proved this. They rested their case partly upon a statistical correlation and partly upon a special interpretation of the theory of marginal productivity. By neither route were they able to make a convincing case for general wage reduction.

There would be no point in discussing the statistical correlation between wages and unemployment except that it is likely to deceive the unwary. It was Professor Rueff who first tried to prove that high wages were the "cause" of British unemployment.¹ He did this by charting the percentage of unemployment alongside of the result obtained by dividing the index of wage rates by the index of wholesale prices. Sir Josiah Stamp took these same figures, covering the years 1919 to 1925, and claimed to find a correlation of $+0.95$ between the movements of the two series. In this way the apparent cachet of statistics was given to the argument that wages should be reduced. The nature of Sir Josiah's calculations remains a mystery, for the writer obtained a value of only $+0.27$ when he computed a Pearsonian R for the same series, 1919-1926 (quarterly intervals). That point is unimportant, however, beside the fact that the whole statistical result is entirely erratic. By varying the exact years of comparison and the exact

¹ Rueff, loc.cit. Cf. also the anonymous pamphlet, L'Assurance Chomage, Cause du Chomage Permanent, Paris, 1931, which has been attributed to Professor Rueff.

measures of unemployment and of price changes, the writer found rates of correlation ranging all the way from $+.68$ down to $+.11$. In truth, the whole validity of correlations between time series is very questionable; there is little defense for correlating ratios in place of the separate terms which compose them. And surely coefficients such as Stamp's, based on only twenty-four observations can have very little meaning. For those who have a taste for this sort of "proof," however, it may be well to state that the coefficient covering 1923 through 1929, all of the years with which our argument is concerned, comes to only $+.26$, establishing no certain statistical relationship between the movements of unemployment percentages and wages/wholesale prices. It may also be observed that much higher (negative) coefficients may be obtained by neglecting wages altogether and simply correlating unemployment and wholesale prices. For the years, 1923-30, for which we have the best figures, a coefficient of $-.72$ may be obtained in this way. Our conclusion is that the "statistical proof" that wages should have been reduced comes to nothing at all. The case for wage-cutting, if any, must rest upon an appeal to economic theory rather than upon these general statistical data.¹

The reasoned case of the advocates of wage-cutting was based upon the well-known theory of marginal productivity. So far as the theory itself goes, it is unassailable. The theory tells us that it will pay the employer to hire labor up to the point at which the marginal value (in money) of the product of the labor force is just equal to the money wages paid to obtain this product. It follows that a sufficient contraction of the money

¹ This was, indeed, the position taken by Professor Pigou. (loc.cit.)

value of the marginal product will cause the employer to contract his labor force, provided that money wages remain unaltered. Now the prices which British manufacturers could obtain for their products did fall, though it should be noticed that the amount of such fall is by no means accurately measured by the index of general wholesale prices.¹ The average of wage rates did not fall. It is, therefore, reasonable to suppose that wage rates may have been too high to make it profitable for employers to engage the whole British labor force under the circumstances.² Such is the real defence for the contention that Britain's heavy unemployment was caused by the high level of wages.

Let us admit that wage rates and marginal value products were out of adjustment from 1925 to 1929. The theory of marginal productivity tells us nothing as to which particular method of restoring equilibrium may be the most practical and equitable. A moment's consideration will reveal that there were grave objections to the method of cutting wage rates. Such a method would have imposed great and unequal sacrifices upon the workers, without the commonly-assumed compensation of increased employment to those who bore the sacrifice.

It may seem strange to argue that wage reductions would have involved a sacrifice. The advocates of wage reduction were fond of pointing out that the fall of prices was equivalent to a rise of real wages, so long as wage rates remained stable. All that they appeared to ask was that real wages be prevented from

¹ Cf. D.H. Robertson, "Britain and World Trade by A.Love-day," Economic Journal, September, 1931, p.439.

² It is quite consistent with this thesis to admit that frictions in the labor market might prevent the whole labor force from being absorbed at any possible wage level. We are concerned with the responsibility for an un-absorbed supply greater than usual.

rising, by making wage rates fall as fast prices. But which prices? Retail prices (Ministry of Labour index of the cost of living) fell by only five per cent between 1924 and 1929, while wholesale prices fell by twenty per cent. If the wholesale-price index be taken as the one which most closely approaches a measure of employer's sales prices, it would seem logical, on "reduction-ist" grounds, to suppose that wage rates should have fallen by twenty per cent. Sir Josiah Stamp went so far as to apply the term, "real wages," to the expression, "wages/wholesale prices."¹ But a cut of twenty per cent in wage rates, so far from involving no sacrifice, would have reduced real wages (wages/retail prices) by sixteen per cent!

The problem just described is always involved when wholesale prices fall faster than retail prices, as they generally do. But the difficulty of wage-cutting is greatly enhanced when the industries of a country suffer contrasting fates. This was the case in post-war Britain. The business depression was concentrated in the so-called "unsheltered" trades, those which directly felt the force of international competition. These trades suffered from the arbitrarily increased value of sterling as well as from trade barriers and foreign inflation, while the "sheltered" trades, catering exclusively to the home market, were able to do very well. In 1928, when the general index of wholesale prices stood at 140 (1914=100), coal at the pit stood at 119, iron at 112, shipping freight rates at 116. In the same year, the index of railway rates stood at 157, retail men's suits at 180, women's wool garments at 250 and general retail prices at 194.5.² There

¹ Stamp, loc.cit.

² Cf. Hugh Butler and others, The United Kingdom, United States Department of Commerce, Trade Promotion Series, No.94, Washington, 1930, pp. 102,185,598,316; A.L. Bowley, A New Index

is no evidence that the contrasts, of which these are merely examples, can be accounted for by corresponding contrasts in the movements of production costs. On the contrary, it seems probable that impossibly large wage cuts would have been required to restore full employment to the unsheltered industries, whereas no cuts at all were required to maintain fairly stable operation in the sheltered trades. All this is obscured by the advocates of wage reduction. By talking of average prices and average wage rates they unconsciously assume that the wage problem was similar in all industries, and that it could be dealt with by the same measures everywhere.

The more thoughtful advocates of wage reduction would presumably admit that wage cuts would involve sacrifice, but they would point to the workers' compensating gain in the form of increased employment. What they should say is that workers as a whole would gain employment, after a fall of prices, if all the costs of production were proportionately reduced. Certainly the fully employed workers, the vast majority even in the worst of times, will gain nothing from cuts in their wages. Nor is it certain that even the whole laboring class will gain as much in employment as they lose in wage cuts. For considerable periods, business will provide a good deal of employment at a loss. The effect of small reductions in wages may be to reduce business losses rather than to cause a proportional expansion in employment. And even when wholesale wage cuts come within the range of practical policy, a failure to reduce the burden of fixed charges must operate to lessen the elasticity of the demand for labor.

The real inequity of wage cuts to remedy British unemployment, however, can be appreciated only by further reference to the contrast between sheltered and unsheltered industries. Instead of computing misleading correlations between time series, the critics of British wage policy would have done better to compare wage levels and unemployment rates in various industries during the same period of time. If we do this, we find that, almost without exception, wage rates were lowest (compared with 1914) in those industries which suffered the most unemployment, and that the trades enjoying high wages also enjoyed good employment conditions. We cannot wonder, then, that workers in the depressed industries, having already taken the largest cuts (between 1920 and 1925), concluded that they had little to gain from further reductions. After observing the miserable failure of wage reductions to restore prosperity to coal mining, other workers must have been confirmed in this belief. Moreover, notes Professor Clay, "on a sectional view of their interests they were probably right."¹ But, it may be objected, wage cuts in the sheltered industries, by reducing the costs of the unsheltered, would have been helpful in increasing the whole volume of employment which could have been provided at a profit. This is true. Lower wage costs in some of these trades would have led to an expansion of their employment. In others they would have made lower selling prices possible and hence would have helped to reduce costs in the unsheltered industries. But the workers in the sheltered trades had good employment conditions already, with the exception of the year 1926 which was disorganized by the coal strike. They had little interest in improving employment elsewhere at their own expense. Nor could they receive much compensation through

¹ Post War Unemployment Problem, op.cit., p. 156.

expansion of their own trades, for this would have required a transfer of large numbers of workers from other trades to compete with them. Under the actual conditions of wage-negotiation in post-war Britain, a sectional view of their interests was the only one the workers could take.

A downward readjustment of wage rates is never easy unless there is a central authority with dictatorial power. It is the general rule that wages fall much more slowly than even retail prices. Under the peculiar conditions of post-war Britain, wage-cutting was the most awkward and inequitable possible method for restoring equilibrium. Nevertheless, the "reductionists" might claim that their contention was established, provided that wage reduction were the only remedy available. This, however, was not the case. There were at least four alternative methods by which unemployment might have been reduced, without the necessity of an attack on money wages.

(1) Instead of returning to the gold standard in 1925, Britain might have adopted a scheme of independent monetary control. We have emphasized the fact that the whole occasion for the demand that wages be reduced was the deflation which had to accompany the peculiar method by which Britain returned to gold. There is more reason to ascribe the subsequent unemployment to this deliberately chosen monetary policy than there is to blame the employment difficulties upon the natural resistance to wage-cuts, once the deflation had begun. Monetary stabilization might have obviated the whole problem. This is not the place to discuss the precise goal or methods of an improved monetary policy. It may be objected that there are many disagreements and uncertainties involved. But there is a good ground for believing that it is easier to stabilize employment by monetary methods than by

tinkering with individual wage rates. Britain already had a centrally managed system of currency and credit. She had no such technique for the central control of wage rates.

(2) If abandonment of the gold standard was believed to be too risky, Britain might have avoided the deflation, of 1925, at least, by de-valuing the pound. If sterling had been tied to gold at the 1924 level, there would have been no immediate necessity for an attack on wage rates. Of course, credit restriction would have been necessary in Britain, had world prices continued to fall under these conditions. But the original ten per cent fall of British prices, about half of the decline before 1930, might have been avoided in this way. And it is possible that much of the subsequent fall in international prices was induced by Britain's own deflationary policy.¹ The necessity for British deflation before 1930 would have been reduced to small proportions, at least, so that employment might have been maintained by other methods, about to be described.

(3) Even if we accept the fall of British prices as inevitable, it does not follow that wage-cutting was the only method of reducing unit costs and restoring profits and employment. The same result may be obtained by improving the physical efficiency of production. Contrary to the belief of eminent authorities,² the average productivity per worker did rise by about ten per cent

¹ This is apparently the opinion of Mr. R.G.Hawtrey. (cf. Currency and Credit, 3rd ed., London, 1930, p.439).

² Cf. Beveridge, Unemployment, op.cit., pp. 366-67. Beveridge accepted the showing of Mr. R.F.W. Rowe's quarterly index of production (cf. London and Cambridge Economic Service, Bulletin, op.cit., April, 1930), and concluded that per capita output had increased by only four per cent between 1924 and 1929. The errors involved in using this index to measure long-time changes in production had already been exposed by Professor Paul H. Douglas and the writer. ("A Measurement of British Industrial Production," Journal of Political Economy, February, 1930). The errors involved in Sir William's inference are treated in some detail by Mr. C.G.

between 1924 and 1929.¹ And there is good evidence to suggest that it might have been made to rise more rapidly, possibly enough to balance the fall in selling prices which did occur and so to restore profits and normal employment without wage-cuts. Professor Clay has shown that rationalization and the elimination of high-cost plants was hampered by two influences: (a) the failure of the banks to put pressure on their industrial creditors under the mistaken belief that the depression was temporary, and (b) the failure of British industries to tap British investment funds so as to make improvements in equipment and business organization. Britain actually exported capital which was badly needed to improve efficiency at home.² In other words, commercial banking policy and investment banking structure operated inconsistently with the monetary policy of deflation. Increased efficiency and lower unit costs were desirable in any case. Given the deflation in selling prices, it was a grave error not to exhaust all possible means to this end before the awkward device of wage-cutting was proposed.

(4) As a supplement to the above methods of restoring employment, a good deal more might have been done by absorbing the unemployed in public works. The idea was steadfastly held by the British Treasury that expansion of public works must force an equal contraction of private employment, and consequently very little was done in this direction. But this idea is based on the false premise that there is always an equality between available

Clark. ("Statistical Studies of the Present Economic Position of Great Britain," Economic Journal, September, 1931, pp. 355-60).

¹ Cf. Clark, op.cit., p. 360; Keynes, Treatise on Money, op.cit., II, p. 87. Approximately the same result was obtained by two independent methods of calculation.

² Post-War Unemployment Problem, op.cit., pp. 138-40, 156-164, 171-74, 188-89, 191.

savings and the active expenditure of these savings by private enterprise for capital purposes. In times of industrial depression, this simply is not so. Indeed, Mr. Keynes has defined deflation in terms of an excess of savings over investment. We cannot here enter upon a detailed discussion of what would have been a suitable program nor upon a refutation of objections. But it is not necessary to believe, with Mr. Lloyd George, that unemployment could have been wholly "conquered" by this method. It would have been a stop-gap, but, in view of the opportunities for lowering costs by increasing efficiency, it would have been a very useful stop-gap.

Here, then, is the refutation of the thesis that unemployment insurance necessarily prolonged the British depression by holding up the wage level. It may, indeed, have stiffened the workers' resistance to wage reduction. But it could do no more than increase the workers' power to defend their own interests. The wage-cutting method of restoring employment was the most awkward imaginable, insurance or no insurance. And there were sufficient alternatives available to make the attack on money wages entirely unnecessary as a remedy for the peculiar unemployment problem of 1925 to 1929.

III. The Tax Burden of Unemployment Insurance

During the summer of 1931, desperate efforts were made in Great Britain to keep the pound on the gold standard, and the leading idea advanced was that there should be drastic reductions in governmental expenditures. A parliamentary committee, headed by Sir George May, reported on this subject, and recommended that more than two-thirds of the £96,500,000 of proposed savings to the exchequer should be obtained by changes in the unemployment

insurance scheme.¹ This report furnishes a striking illustration of one form of attack on the supposed economic effects of compulsory insurance against unemployment: the contention that Britain's peculiar depression was due to the weight of taxes collected to support the insurance system. To be fair to the critics, we must not limit our attention to the state contribution for insurance. All of the revenues for a compulsory system must ultimately be obtained from some form of taxation. Now the insurance fund in Britain was forced to expend slightly more than £50,000,000 per year, during the period 1925 through 1929, and in 1930 this sum rose to £86,600,000, or, say 1.5 per cent of the national income, rising to somewhere between two and three per cent. May we not find in this expenditure the explanation of a crushing burden of taxation which kept British industry in a depressed state?

This view would be plausible, provided that the whole of this insurance expenditure had brought about a corresponding net addition to the tax collections, and provided that the taxes imposed for this purpose had been of the type which have a depressing effect upon industry. In fact, unemployment insurance made only a modest addition to the tax burden, and gave rise to taxes which were not particularly onerous.

The whole of the expenditure on insurance in 1929 was less than fourteen per cent of the aggregate expenditures on British social services,² and the average expenditure from 1921 through 1930 was only 5.5 per cent of the national budget during those years.³ This is enough to show that insurance was not a

¹ Committee on National Expenditure, Report, 1931 cmd. 3920, pp.217-28.

² Cf. Committee on National Expenditure, op.cit., p.143.

³ Cf. Ministry of Labour, Report on National Unemployment Insurance to July 1923, London, 1923, pp.228-29; idem, Annual

major factor in the forcing up of British tax rates. But it would be wrong to conclude that insurance added even five per cent to the budget. First of all, we must add in the expenses of the local governments. When we do this, the insurance expenditure drops to about 4.6 per cent of the whole.¹ Then we must take account of the fact that those of the unemployed who were destitute would have been granted public poor relief in any case. In spite of the heavy post-war expenditures for poor relief, it is certain that these would have been still greater if there had been no insurance system. Naturally, it is impossible to tell exactly what these expenditures would have been under different circumstances. But the writer estimates that only two-thirds of the actual expenditure on insurance benefit was a net addition to the relief charge.² On this basis, we discover that unemployment insurance, between 1921 and 1929, added no more than three per cent to the aggregate expenses of British taxing bodies. Taxes to raise such a sum would have had to be onerous indeed to have been a significant cause of industrial depression.

When we examine the methods used to provide revenues for the insurance fund, we find still further reasons to discount the arguments of the critics. About one-sixth of the post-war expenditure was met by borrowing. Lest it be feared that this borrowing

Reports, 1924-1930, *passim*; Board of Trade, Statistical Abstract for the United Kingdom, No. 75, 1932 cmd. 3991, p. 129, Committee on National Expenditure, *op.cit.*, p. 273.

¹ *Loc.cit.*, The year, 1930 is omitted from this last comparison because figures for local government expenditures were not available. But this one year cannot greatly affect the average, and in any case we are primarily interested in causes of the peculiar depression of British industry in the years before 1930.

² This estimate is based on a study of the transfer of workers to the poor relief centers during periods when they were, for various reasons, disqualified for insurance benefit. (cf. Report on National Insurance, *op.cit.*, pp. 221, 223; Report of the Ministry of Labour for 1923-24, 1925, cmd. 2481, pp. 130-31; Min-

caused depression by ruining the credit of the government, it should be stated that the government paid successively lower rates on this borrowing during the period, in spite of the fact that larger and larger sums were required.¹ Indeed, it is one of the virtues of unemployment insurance that the collections are made principally in good years while, the purchasing power is released in depressed years without equal tax collections. Had Britain's insurance fund collected contributions on behalf of the whole industrial population from its beginning in 1911, the accumulated surpluses would have met most of the post-war expenses without even the need for borrowing.

More than one-quarter of the post-war insurance expenses (about one-third of the collected contributions) was met by contributions exacted from the workers themselves. Since the employer had the power to deduct any such collections from the wages paid, there is no reason to think that this part of the insurance burden fell upon industry. There was left less than sixty per cent of the expenditure to be collected by means of taxes which might fall upon industry. Of this, nearly half was obtained from contributions of the national government, ultimately met by the whole array of taxes which fed the exchequer. Since about one-half of the national revenues in Britain are obtained through income, profit, estate and land taxes, which have the minimum depressing effect on enterprise, the burden on British industry from this source must have been negligible.

We have left the employers' direct contribution to the

lentry of Labour Gazette; passim; Royal commission on Unemployment Insurance, First Report, 1931 cmd. 3872, pp. 18-21). The May Committee estimated in 1931 that relief expenditure could be reduced by only one-half by transfers from insurance to the poor law. (Report, op.cit., pp. 149-50).

¹ Cf. Ministry of Labour, Report for the Year 1930, 1931 cmd. 3859, p. 131.

insurance fund which was, so far as it went, a tax on employment. But only thirty per cent of the insurance expenditures were met in this way. The studies of the Balfour Committee lead us to the conclusion that the average of £16,000,000 per year which were collected directly from employers could not have added more than one-half of one per cent to average production costs, nor more than 1.75 per cent to the average wages bill.¹ Even in extreme instances the employer's insurance expense amounted to no more than one per cent of production costs or three per cent of the wages bill.² It is impossible to suppose that such charges on industry could significantly affect the volume of profitable employment, even if we make a generous estimate of the depressing effect of other taxes falling on the employer because of the state contribution to insurance.

And this is not all. The abolition of unemployment insurance would have made necessary a heavier expenditure for poor relief. We have estimated that one-third of the insurance expense would have become poor relief expense. The saving in total expenditure would have been offset by a transfer of about £15,000,000 of burden onto the local authorities, adding about ten per cent to the local budgets. Of all the forms of taxation in Britain, the one which certainly had the most depressing effect upon

¹ This conclusion is deduced from evidence presented at various places in the reports of the Committee on Industry and Trade. (Final Report, 1929 cmd. 3282, pp.254-55; Factors in Industrial and Commercial Efficiency, 1927, pp. 477-83). The committee did not separate the burden of unemployment insurance contributions from that of other social charges, but it is possible to make a close estimate of the insurance charge.

² There was only one case of an engineering firm (Firm B) where wages themselves formed only 12.5 per cent of production costs, and in this case it seems possible that the insurance contribution might be as much as 4.32 per cent of the wages bill. But this was not typical, and it may be said that neither the wage nor the insurance charge would have much influence upon the conditions of profitable operation of such a firm.

industry was that of the local rates out of which poor relief had to be paid.¹ This was partly because these rates were property taxes, but principally because they were locally assessed. Thus, wherever industry was in distress, there would be an abnormally heavy bill for relief, making necessary a heavy tax burden. If one set out to contrive a tax which would be levied in inverse proportion to ability to pay, it would have been hard to devise one more burdensome than this. If unemployment insurance did increase somewhat the total of required tax collections, it made up for this by reducing the required collections of the worst tax which Britain possessed. On the balance, it is hard to see that the tax burden of the insurance system had any depressing effect upon British industry whatever.

IV. Insurance and the Organization of the British Labor Market

Unemployment in post-war Britain has been very unequally distributed. This was especially true during the years, 1923-1925 and 1927-1929, the very years when there was no world-wide depression nor general disturbance, such as a coal strike, to explain why Britain did not regain normal employment conditions. There were striking contrasts in such years between the unemployment rates of different industries and of different geographical areas. If we take the June unemployment rate during the seven years, 1923 through 1930, omitting 1926, we find an average rate of over sixteen per cent in shipbuilding, dock work, general engineering, cotton manufacturing, public works construction, coal mining and

¹ The writer is aware that part of the local burden has been assumed by the national government since 1928 by the scheme of derating. In the writer's opinion this measure was not an important answer to the problem of local rates. (cf. Clay, Post-War Unemployment Problem, op.cit., pp. 121-22, 159-62). In any case, it came too late to affect the main argument here presented.

It is possible that the current plan of having local authorities assess the needs of insurance claimants who have

and shipping. During the same period, there were twenty trades, each employing more than 100,000 workers, in which the unemployment rate was less than half that figure. Shipbuilding had an average rate of nearly 29.7 per cent while only 2.9 per cent of the insured workers on tram and bus lines were without work. Between 1927 and 1930, the whole South-Eastern section of England had an average unemployment rate of only six per cent, while Wales had a rate of 21.9 per cent. The contrasts between more limited areas was naturally even more extreme. On October 26, 1925 there was unemployment of more than forty per cent in the areas of ten local employment offices, while ten other local areas had rates of less than two per cent. Bargold in Wales suffered involuntary idleness of 64.7 per cent of its insured workers on the same day that High Wycombe, near London, had a rate of only one per cent.

Such contrasts suggest that Britain needed a different distribution of its working population. May it have been dis-organization of the labor market which perpetuated the heavy volume of unemployment, even in the best of the post-war years? If so, this raises questions as to the success of the nation-wide system of employment exchanges, which were set up as early as 1910. Unemployment insurance has been blamed for Britain's failure to reduce idleness more effectively by means of these exchanges. Mr. Felix Morley framed the reasoned indictment in 1924. "Once state-operated unemployment insurance was initiated," he contended, "employment exchanges never had a chance.....While state-operated unemployment insurance may need state-operated employment exchanges to make it possible, the need is not reciprocal..... The association

exhausted their claims may combine rating relief with a saving in total expenditure. But our problem is not whether the total insurance expenditure might have been reduced, but rather to determine whether the actual expenditure was a depressing influence as against the usual alternative of public poor relief.

of insurance with the exchanges has played havoc with the due and necessary development (of the latter)...."¹

Mr. Morley wrote a timely study which got into print before the evidence on this matter was all in. From the vantage ground of later years, one would say that he reached a warped conclusion because of near-sightedness and astigmatism. He observed that employers reported only 840,000 jobs to the exchanges in 1922, as against over two million in 1918 and that the actual placings sank from 1,500,000 to 697,000 during the same period, in spite of the fact that twice as many persons registered for work. He observed the necessary emphasis on administration of insurance benefits during the early years of depression and the neglect of attention to the placing work. He undoubtedly heard the grumbles of employers about state interference with their affairs, a reaction from war experiences. Piecing the picture together, he concluded, perhaps naturally, that the administration of unemployment insurance by the employment exchanges was bound to interfere with their work of job-finding and man-finding.

There were certain facts, available even to Mr. Morley, which were left out of the picture. The reader was not told that unemployment insurance was already contemplated in 1909 when the Labour Exchanges Act was passed. Even if some public employment offices would have resulted from the reports of the Royal Commission on the Poor Laws, it is doubtful whether such exchanges would have been so complete and integrated, but for the fact that they were regarded as a necessary first-step toward unemployment insurance. The original introduction of insurance certainly did not interfere with the placement work of the exchanges. In the

¹ Unemployment Relief in Great Britain, New York, 1924, pp. 9, 145.

year after benefits were first paid, placings climbed by nearly 200,000, the ratio of placings to worker registrations rose slightly, and the ratio of placings to the number of jobs reported remained unaltered. During the war-period, every indication pointed to increasing scope and efficiency of the placing work. In 1918, the exchanges succeeded in filling 77.8 per cent of the jobs reported to them, and they succeeded in placing 44.7 per cent of the workers who registered with them.

Nor did the real deterioration begin with the extension of insurance in 1921. It began in 1919. In spite of the fact that a business boom was then in progress, placings fell off by 40,000, the ratio of placings to jobs reported fell to 73.3 per cent, and the ratio of placings to worker registrations, most surprising of all, fell to 41.8 per cent.

It is true that the striking decline in number of placings came between 1920 and 1921. But this is hardly surprising. The business depression had glutted the labor market. This decline, in itself, does not prove deterioration, any more than the higher ratio of placings to jobs reported proves that the exchanges were improving. Both changes sprang from the same cause, fewer jobs available and hence a greater selection of workers for each job. It is also true that more time, space, and attention were devoted to the paying of insurance benefits during 1921 and 1922 than ever before. But this hardly indicates that unemployment insurance must necessarily be an obstacle to effective exchanges. The administration of relief was a matter of urgent necessity. The magnitude of the depression had not been anticipated. The exchanges were understaffed, and heavily burdened with temporary and untrained clerks. Their appropriations were limited. Employers were frequently hostile toward the exchanges

because of the way in which they had been used to take labor away from them according to government directions during the war, and because the exchange staff had been used for unpopular inspection purposes. In any case, employers found it easy to meet their labor requirements by drawing on the men waiting at their gates. It was this evidence which made Mr. Morley believe that unemployment insurance, if operated at all, should be separated from the exchanges and managed by industries separately.

"Insurance by industries," Sir William Beveridge has observed, "in spite of loud backing by professional critics of state action, proved to be a horse that would not run."¹ This was fortunate, even for the exchanges, for, pace Mr. Morley, the administration of insurance carries with it a very real advantage for their placing work. Insurance makes it certain that the whole body of available workers will be registered at the central labor market. Without insurance, public employment offices are commonly the places of last resort, frequented by the poorest workmen and used by the worst employers alone. Unless, indeed, there is a stringent restriction on the use of competing agencies, not very much is likely to be accomplished under these conditions. With the registration which insurance brings, the exchanges have something to offer the employer which can make them a real power if they will but make intelligent selection and if the employers can be persuaded to give the public offices a trial.

The employment exchanges have continued to administer the insurance system, but the work of placing has not continued to deteriorate. On the contrary, each succeeding year since 1922, with the exception of the coal-strike year, 1926, has seen a larger volume of placings accomplished than before. And when the

¹ Unemployment, new ed., op.cit., pp. 291-92.

depression of 1930 again made vacancies especially scarce, the placings of the exchanges continued to increase, until at present vacancies are actually being filled at the rate of about 2,000,000 per year. This volume of work is one-third greater than that of 1918 when employers were clamoring for men. The number of vacancies reported by employers has continued to grow, in spite of continued and intensified depression and in spite of the supposed prejudices set up when exchanges administer unemployment benefits. And the ratio of placings to the jobs reported to the exchanges has improved at the same time. At present the exchanges, in competition with all other hiring agencies, succeed in placing the man they select in nine vacancies out of every ten reported to them.

The exchanges are now filling about 200,000 vacancies per year in the trades of agriculture and domestic service, where the workers are not insured. The growth in this figure indicates that the exchanges are efficient enough to commend themselves even where they cannot obtain complete worker registration. At the same time, the disadvantage for placing of not having these trades insured is clearly indicated by the relatively small absolute number. In certain skilled occupations which it is possible to select out from the published returns, the placings have increased by 228 per cent since 1922, as against an increase of 121 per cent for all men. The exchanges are evidently not limited to the placing of common labor in the insured trades and they are making good progress in dealing with their more difficult placing problems. Moreover, the exchanges are having an increasing measure of success in placing workers at a distance. In 1929, 17.6 per cent of all placings were "cleared," that is to say that the man was found a job at a place outside the local area of the exchange where he had registered. This is in contrast to "placement clearings" of only

8.4 per cent in 1921 and of only 12.2 per cent in 1913 before the exchanges had the present mass of insurance work to handle. This work was especially important in view of the geographical shift of Britain's industries, and the British exchanges were uniquely equipped to handle it.

The suspicion was once held by the writer that the administration of relief must necessarily cause the exchange to send to the employer a man whom the insurance authorities wished to cut off the benefit list. It might seem convenient to use the list of vacancies to rid the insurance system of long-standing benefit burdens, or at least to test the willingness of men to work where this might be in doubt. This suspicion must be set at rest. The exchange officials are quite aware that such a policy would cripple their reputation with employers. There is no evidence that the exchanges have ever tried to send the employer an inferior workman when a better worker was available, although, of course, the exchange's ability to select the best man may have varied from time to time and place to place.

It is now revealed that the absorption with relief administration, to the prejudice of placing activity, was a temporary phenomenon. The depression of 1921 caught the exchanges with the job of handling over one million claims to benefit a week, and this in premises which were largely temporary makeshifts and with a staff of which four-fifths were temporary, untrained clerks. On top of this, there were eleven important changes in the insurance act within four years. The depression of 1930 found matters in very different shape. The exchange premises, although not ideal, had been much improved. Placement work and insurance administration were usually conducted at separate counters, and there was space for private interviewing. Half of the staff were

permanent and experienced civil servants. The routine was well ordered. Most important of all, the oversight over placing work had been separated from that of benefit administration, an assistant secretary of the Ministry of Labour being in charge of each. This had the incidental result of insuring that a minimum of placing staff would be kept on this work, no matter how pressing the demands of benefit administration might become. What was needed in 1921 and 1922 was not the abolition of insurance nor its separation from the exchanges, but a chance for the exchanges to catch their breath after the war-time diversion of their staff and premises and a chance for them to develop some experience in dealing with the vast increase in the register which the extension of insurance had brought to them.

There is no need to ignore the darker side of employment conditions in Britain. The exchanges have no power to create jobs, and the continued deflation of business profits since 1925 has made a large volume of unemployment inevitable, in spite of all that mere organization of the labor market might do. Nor have the exchanges been able to eradicate the disparities in unemployment rates between different trades and different areas. For one thing, they have been limited by the very slow expansion even of those trades which have had low rates of unemployment. Besides this, the exchange system has not become the exclusive, nor even the most important, hiring agency in Great Britain. In the insured trades the exchanges handle about one-fifth of all the hiring, as against four-fifths by all methods independent of the exchanges. This is sufficient to make them a very real force toward the orderly marketing of labor, but it is still far from that complete organization which might reduce unemployment to the minimum. For this there is no remedy, so long as employers are

free to hire in any way they choose, except continued efficiency in selecting workers which will gradually make the use of the exchanges obviously advantageous to the employer who is now prejudiced against them. It has been frequently suggested that all employers should be compelled to report all their vacancies to the public exchanges. But it is difficult to see how this could accomplish much good, if the employer were free to refuse to accept the workers recommended by the exchange. And it would very probably stir up intense antagonism by the employers against the state agency which saddled them with such a bothersome and meaningless routine.

But if the exchanges have not wholly succeeded in reducing the friction of the labor market to the minimum, this has not been because of pre-occupation with unemployment insurance. There is every evidence of a vigorous attack upon the unemployment problem. If insurance has had any influence, it has been to provide an awareness of the necessity for exceptional measures and an exact knowledge of the nature of the difficulties. The Ministry of Labour has not been content merely to select and to recommend the obviously available workers for jobs voluntarily reported to it. It has actively sought co-operative hiring arrangements with employers. It has constantly attempted to further schemes of decasualization for the most irregular trades. It has engaged in extensive vocational guidance and training work among juveniles. And it has made an intensive effort to re-train and transfer adult workers from the most depressed areas.

These efforts have met with varying degrees of success. Co-operation with employers has proved very successful, as is shown by the increasing number of vacancies reported even after the labor market grew more depressed. Decasualization has been

almost a complete failure. The most that can be said is that the drift into the casual trades which characterized previous periods of depression, seems to have been stopped. Juvenile guidance through specialized officers of the exchanges has cemented the contact with youth so securely that by 1930 the exchanges filled 300,000 vacancies for juveniles. This compares with only 700,000 children leaving school each year, and with a juvenile population of only two millions. The training of juveniles during unemployment was, by 1930, carried on in as many as 115 centers simultaneously and reached 15,000 such workers. By means of the so-called "Industrial Transference Scheme," the Ministry succeeded in reaching 72,000 stranded workers within the three years, 1928-1930, of which all but 5,000 were restored to jobs which they had no chance of securing before individual attention was given to them. Since the war, more than 50,000 women have been given training at government expense, mostly for the purpose of fitting former factory workers for the growing occupation of domestic service. Since 1925, 35,000 adult males have been given special training to fit them for new occupations, made necessary by the contraction of the especially depressed industries.

These constructive employment activities of the Ministry of Labour are a fit subject for an extended study by themselves. But for our present purpose it is enough to see there have been tangible efforts, hardly to be matched in any other country. At many points the existence of an established system of unemployment insurance has been a distinct aid to these efforts. And at no point has the insurance system been important in limiting the effectiveness of the Ministry's efforts to deal with the employment problem.

The contention that unemployment insurance has hampered

Britain's efforts toward improving the mobility of labor is the reverse of the truth. For a short period during the crisis of 1921-1922, it is true that the employment exchanges were deluged with insurance administration. But subsequent years have shown that this was not a permanent or necessary condition. The constructive efforts of the exchanges and of the Ministry of Labour have grown steadily more effective. Insurance, in latter years, has not interfered with attention to employment work nor has it prejudiced the methods of the exchanges. Meanwhile, it must be remembered that the establishment of insurance helped to insure a complete and co-ordinated network of exchanges and to keep this organization in operation when it otherwise might have been dropped, as were the war-time employment offices in the United States. Finally, unemployment insurance, by providing the exchanges with a complete register of available workers, is of material assistance in giving the public employment offices a valuable hold on the labor market.

V. Unemployment Insurance and the Willingness to Work

Probably the most firmly rooted impression concerning unemployment insurance is the belief that it must make the laborer unwilling to work. This belief is reflected in the very numerous popular remarks concerning labor that is supposed to be "pauperized by the dole." It is really very difficult to secure convincing evidence to test this proposition, and that is, perhaps, the reason why loose remarks on the subject are so common. An ideal method would be to conduct an extensive case study of the unemployed on the basis of careful sampling. The present analysis presents no such results. Nevertheless, some good may be accomplished by considering the evidence which is already available concerning the willingness to work of the insured population of

Great Britain.

It is entirely unnecessary to seek the explanation for Britain's unemployment by appealing to a supposed demoralization of workers through insurance. Adequate alternative explanations are available, both for the very heavy rates of 1921-1922 and 1930-1932 and for the failure of the rate to fall below 9 per cent in the intervening years. Moreover, there is positive evidence that the mass of Britain's unemployed have been very anxious to resume work. If they had been content to draw insurance benefit in idleness, presumably they would have remained idle for long periods. Many persons doubtless believe that such was the case. No fewer than one million workers were idle at all times since 1921. But they were not always the same persons. During 1927, for example, the average turnover of the unemployed was 363 per cent. And on February 2, 1931 it was discovered that only five per cent of the unemployed had been out of work a year before. This was after British industry had been severely depressed for more than a year, and it was ten years after the general post-war depression had commenced. So far from being "work shy," the great mass of workers were not only anxious to find work but they had also succeeded in finding it, in the face of extremely adverse conditions. The remaining five per cent may have been equally anxious, for all that we know. But it is, at any rate, definitely established that most of the unemployed in Britain have been a rapidly circulating body of individuals. Every one of the seven sample investigations, conducted by the Ministry of Labour at various times since 1923, have presented a consistent picture in this regard.

The writer has checked the impression left by these investigations by comparing the scale of insurance benefits with

the lowest scales of wages which unskilled British laborers might expect to earn while in employment. Insurance benefits in Great Britain have never been graded according to the past earnings or industrial classification of the individual, but the basic rate of benefit has been supplemented, since 1921, by allowances for a dependent wife or husband and for each dependent child. It follows that the greatest temptation to idleness must appear among unskilled workers who, at the same time, have large dependent families. This effect is interesting, for it means that demoralization is not likely among skilled workers nor among single men and women, the classes which are naturally most independent. It seems probable that single men in Britain would always have been able at least to double their income by earning wages in place of drawing unemployment benefit. And single women could have added at least one-third to their earnings in this way. If they could have commanded anything above the lowest wage rates, the advantage of working would have been greater, of course. It is only among the working women with an adult or several juvenile dependents and among men with five or more children that we find that unemployment benefits came close to the possible earnings from wages. Men with dependent wives and five or more children formed only four per cent of the working population, and the whole class of working women having any dependents at all constituted only five per cent of the industrial population. Many of these would be able to earn better than the lowest wage rates and so could not be tempted to prefer idleness. The residue of those who had little to gain by working was certainly insignificant.

It is by no means certain that unemployment insurance acted to demoralize even that small class who might have drawn benefits equal to their normal wages. A man who could earn

nothing above the lowest wages and who was attempting to support a wife and five children on such a wage, must have been pretty well demoralized in any case. Probably he would have been dependent himself, upon poor relief or some form of charity. The fact that he could draw unemployment benefit could not alter his viewpoint materially.

Moreover, it must not be supposed that the insurance system allows a worker to choose freely between employment and idleness. A worker who voluntarily leaves his work or who is discharged for disciplinary reasons is disqualified for benefit upon the report from the employer to that effect. Likewise, the worker cannot draw benefit during unemployment which results from a labor dispute. Each claimant must register for employment at the same time that he applies for benefit. The failure to apply for work or refusal to accept a suitable offer results in disqualification. Before 1921 and since 1931, the individual's benefit was limited to a stated number of weeks a year. And during the interval, with the single exception of the year, 1930-1931, it was always necessary for the worker who had drawn benefit for a long period to satisfy a special investigating committee that he was making every reasonable effort to find employment. The worker who had long been idle was frequently forced to accept lower-paid employment in a new trade or suffer a stoppage of his benefit.

It must be admitted that special circumstances have created a temptation to draw benefit instead of wages in the case of some limited classes. (1) There are the workers on "broken time": those who were habitually employed for a fraction of a week, casual workers, and seasonal workers. Such persons might be regularly employed for only part of the normal working time and might be able to draw benefit at other times, though they

had no intention of seeking further work. (2) There is the special problem of married women. If they had been employed as single women, it is likely that this work would be stopped at the time of marriage. In a depressed labor market, it was difficult for such women to find new employment, no matter how much they wished it. But although they might have had no intention of seeking further work, it was possible, before 1931, for them to register for work and draw benefit when none was found. (3) Finally, there are the short-time workers. These usually desire work and are genuinely unemployed. The difficulty is that employers have some times arranged the working schedules so that they might draw benefit during the "time-off." This may be a good method for avoiding complete discharge during temporary slackness, but when it is continued for long periods, it must have the effect of keeping an unnecessarily large number of workers attached to the industry. Since combination of part-time wages and part-time benefit may afford such a worker a decent support, he will naturally be loath to seek other employment.

The classes just described have been termed the "anomalies" of unemployment insurance. Since the first report of the recent Royal Commission they have been given special treatment. Workers on broken time and short-time workers can now draw benefit only up to the point where benefit plus wages equals the "normal earnings" of such workers. A married woman can draw benefit only if she satisfies the authorities that she has not abandoned insurable employment and that she can reasonably expect to be re-employed in the district in which she lives.

These special problems of insurance have been mentioned in order to avoid the appearance of ignoring any evidence of demoralization which may exist. The whole problem is not a very

large one. The Royal Commission estimated that it would be possible to save only four per cent of the whole benefit expenditure if all such workers who were not seeking work were cut off from benefit. A good deal less than four per cent of the unemployed workers would thus be indicated, since such claimants would naturally draw benefit for longer periods than the average worker. Nor is the "anomalies" problem a true indication of unwillingness to work. It was not so much that these workers preferred idleness as that they were able to draw benefit under circumstances for which the insurance system had not been designed.

The most that can be said at present is that no evidence exists to show that the British insurance system has had an adverse effect on any considerable numbers of workers. All the concrete evidence points the other way. The alternative explanations for Britain's unemployment, the turnover among the unemployed, the comparison of benefit and wage scales, and the special character of those cases where individuals drew benefit for long periods -- all of these approaches to the problem bring us to the same conclusion: that demoralization by insurance, as distinct from demoralization from idleness itself, has been negligible, if it has existed at all. Many individual cases which are often cited to prove the contrary have been studied by the writer. Most of them have turned out to be cases where the facts cited were incomplete, cases of misunderstood facts, or cases of invidious moral judgment passed upon the desires of the worker involved. Certainly it is absurd to believe that "pauperization by the dole" furnishes any explanation of the problem of unemployment in post-war Britain.

